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SUBJECT: SCENESETTER: SECRETARY OF COMMERCE CARLOS
GUTIERREZ'S SEPT. 12-13 VISIT TO PANAMA

This message is sensitive but unclassified. Please protect accordingly.

1. (U) Welcome and Summary. Embassy Panama extends a warm welcome to you and your delegation. Your engagement in Panama can help strengthen our bilateral relationship, boost support for the U.S.-Panama Trade Promotion Agreement (TPA), reinforce U.S. export opportunities regarding the \$5.25 billion Panama Canal expansion project and other multiple opportunities, and advance broader U.S. economic and social interests. Your visit comes at a time when Panama enjoys an economic boom while, at the same time, it endeavors to overcome stubbornly high levels of poverty, yawning income disparities, high unemployment, widespread corruption, and poor educational and healthcare systems. Public support nonetheless remains solid for both the Torrijos Administration and free trade, as evidenced by the National Assembly's nearly unanimous ratification of the TPA within two weeks of its June 28 signing. You will have the opportunity to meet with top GOP officials, local media, and a cross-section of private sector and civil society leaders.

2. (SBU) Your visit follows President Bush's March 2007 Latin America tour and other recent high level Administration visits, including: Deputy U.S. Trade Representative John Veroneau (March), Transportation Secretary Mary Peters (May), Deputy Secretary of State John D. Negroponte (May), Secretary of State Condoleezza Rice (June), Health & Human Services Secretary Mike Leavitt (June), and several Congressional

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delegations. Your visit also comes on the heels of Panama's September 3 formal launch of the Panama Canal expansion project and commemoration of the thirtieth anniversary of the signing of the Panama Canal Treaties, which brought former President Jimmy Carter, Senator Robert Byrd, and several Latin American heads of state to mark the occasion.

3. (SBU) Your visit also comes on the heels of the Panamanian National Assembly's widely criticized selection of its new President, Pedro Miguel Gonzalez, who is indicted by the U.S. for the 1992 killing of U.S. serviceman Zak Hernandez in an act of terror in Panama. In accepting the post on September 1, Gonzalez held out the possibility of stepping down should his presence become an "obstacle" to the U.S. Congress' ratification of the TPA. End Summary.

Panama Sees Boom in GDP and Investment

14. (U) With 8.1% GDP growth in 2006, Panama's economy saw its fastest growth in 14 years, surpassing growth of 6.9% in 2005 and 7.5% in 2004. GDP growth for 2007 currently tops 9% and some private analysts predict it may exceed 10% by 2008. Panama's dollarized \$15 billion/year economy is based primarily on a well-developed services sector that accounts for roughly 80% of GDP. Services include the Panama Canal, banking and financial services, legal services, container ports, the Colon Free Zone (CFZ), and flagship registry. The Panama Canal accounts for approximately 5% of Panama's GDP directly, and between 23% and 35% indirectly. The maritime industry accounts for approximately 20% of Panama's GDP.

15. (U) The GOP estimates that inflows of Foreign Direct Investment (FDI) exceeded \$2.4 billion in 2006, more than double that of 2005. However, this result was skewed by HSBC's \$1.8 billion purchase of Banistmo (Panama's largest bank) in November 2006. The stock of U.S. FDI in Panama, which currently totals about \$5.2 billion, is concentrated primarily in the maritime, energy, and financial sectors. Growing numbers of U.S. and other foreign retirees have helped drive Panama City's skyline upward, boosted the country's impressive construction boom over the past several years, and prompted closer ties between U.S. and Panamanian real estate industries. Although the GOP has tightened its banking supervision considerably over the past decade, money laundering remains an ongoing challenge and is increasingly of concern in other sectors, such as real estate and the gaming industry.

Panama Embraces Free Trade

16. (U) Panama maintains one of the most liberalized trade regimes in the hemisphere. As Panama's largest trade partner, the U.S. consistently maintains a huge trade surplus with Panama. Two-way trade so far this year (through June) exceeds \$1.8 billion, which includes more than \$1.6 billion in U.S. exports and about \$168 million in Panamanian exports to the U.S. Two-way trade in 2006 reached nearly \$3.1 billion, an increase of 24% over 2005's trade of nearly \$2.5 billion. The U.S. exported about \$2.7 billion to Panama and imported \$378 million.

17. (U) Reflecting Panama's enthusiasm for free trade, the National Assembly ratified the U.S.-Panama TPA on July 11, 2007 by an overwhelming 58-3 margin. TPA opponents came mainly from the ranks of left-wing extremists whose opposition proved sparse and disorganized. Virtually all business sectors have lined up in support of the TPA. Although leading labor groups had initially presented a strong anti-TPA front at the outset of negotiations in 2004, they ultimately splintered on the issue. CONATO, the main council of confederated labor unions, voted narrowly (4-3) to support the TPA in June 2007.

18. (U) Panama has existing free trade agreements in place with El Salvador, Taiwan, and Singapore, as well as partial trade agreements with Mexico, Colombia, and the Dominican Republic. In December 2006, the National Assembly unanimously approved a bilateral free trade deal with Chile. In March 2007, Panama and Honduras concluded their FTA negotiations. Panama continues to negotiate separate FTAs with Costa Rica, Guatemala, and Nicaragua.

ACP Launches \$5.25 Billion Panama Canal Expansion

19. (U) Since the December 31, 1999 handover of the Panama Canal by the U.S., the Panama Canal Authority (ACP) has proven itself an able administrator, turning the Panama Canal into an efficient and profitable business. The ACP has cut average Canal transit times, reduced accidents in Canal waters, and has overseen large-scale upgrade and maintenance projects. The ACP also has tripled Canal revenues since the

handover, topping \$1.5 billion in 2006. In 2006, the ACP remitted to the national government \$570 million. To protect the Canal's vital water resources, the Panama Canal Authority (ACP) has matched a \$2.5 million fund that USAID put in place to better manage the Canal watershed.

¶10. (U) In October 2006, Panamanians voted overwhelmingly (78% to 22%) in favor of the proposed expansion of the Panama Canal. This project entails primarily construction of a "third lane" and two new sets of locks to accommodate larger, "Post Panamax" ships. The ACP formally launched construction activities on September 3, 2007 in ceremonies attended by former President Carter and other dignitaries. The GOP expects the project will be done in 2014. Panamanians hope that it will be a transforming event that provides jobs and sets the tone economically for many years.

¶11. (U) Given growing trade between East Asia and the U.S. eastern seaboard, the expansion is central to maintaining the Canal's future viability. The ACP plans to finance the project through a combination of Canal revenues, increased tolls, and \$2.3 billion in bridge loans. The Embassy has consistently stressed the USG's desire for clear and transparent contracting rules that offer fair opportunities to U.S. bidders. U.S. firms have done well thus far in the competition for early contracts, including CH2M Hill's recent win of a 7-year project management deal with the ACP. Some in the construction industry worry that Panama has nowhere near the number of skilled workers necessary for the expansion project, particularly English-speaking workers.

Poverty, Unemployment, Corruption & Other Challenges Remain

¶12. (SBU) At \$4,900, Panama's per capita GDP ranks among Latin America's highest. President Torrijos hopes that sustained growth resulting from the Panama Canal expansion project and the TPA will help push Panama into "first world" status. However, neither the Canal nor the TPA is a panacea, as cronyism and weak institutions (especially the notoriously corrupt judiciary and troubled health and education sectors) have kept Panama's solid GDP growth from translating into broadly shared prosperity. Panama is second only to Brazil in having Latin America's worst income distribution. Poverty persists at nearly 40% overall (higher than 80% in some rural areas), and unemployment remains high (officially about 8.6%, with more than 20% underemployed) despite showing some signs of improvement in the past two years.

¶13. (SBU) Corruption is widespread in the Panamanian judiciary. Despite campaign promises by President Torrijos to eradicate corruption, there have been no significant indictments or prosecutions for official corruption. In December 2005, the USG revoked the visa of sitting Panamanian Supreme Court Justice Winston Spadafora. In September 2000, the USG revoked the visa of ex-President Ernesto Perez Balladares for his involvement in alien smuggling. The Embassy is focused on working with Panamanians to promote good governance and to help them better address the risks posed by public mismanagement, corruption, and persistent urban poverty and hopelessness.

¶14. (SBU) The lack of an effective educational system and the lack of support for small business development are two factors that contribute to Panama's high poverty levels. Despite spending 12% of the national budget and 5% of GDP on education, Panama's workforce remains poorly educated. About half of prospective University of Panama students recently failed their entrance exams, prompting university authorities to lower the threshold for entrance. Acutely aware of the political blow-up the could result from filling the Panama Canal expansion project with skilled foreign workers, the GOP is spending \$85 million to train Panamanian workers hoping to work on the project. However, about one-third the training program's applicants cannot begin the program because they lack the basic literacy

and math skills required.

Torrijos Enjoys High Approval Despite Challenges & Missteps

¶15. (SBU) Since taking office for a five-year term in September 2004, the Torrijos government set its principal priorities as canal and maritime security, economic development, job creation, poverty alleviation, investment, fiscal reform, and "eradicating corruption." Torrijos faced large challenges from the outset: a serious budget shortfall; a near-bankrupt national retirement and medical system (the Social Security Fund); and faltering public confidence in government institutions and the rule of law. Although pressures from entrenched interest groups slowed GOP fiscal reform efforts, Torrijos' 2005 fiscal reform package - together with tax revenues driven by impressive economic growth - brought the GOP into a fiscal surplus (0.5% of GDP) by early 2007, Panama's first such surplus in ten years.

¶16. (SBU) Three years into his five-year term, Torrijos continues to enjoy nearly 60% public approval, despite weathering bruising battles over fiscal and social security reforms, the Canal referendum, crises in healthcare and transport sectors, and having little to show for his promise to eliminate corruption. His Revolutionary Democratic Party (PRD) controls Panama's unicameral National Assembly and other governmental institutions.

¶17. (SBU) Driven by the internal politics of the PRD majority, the National Assembly on September 1, 2007 selected Assemblyman Pedro Miguel Gonzalez as the Assembly's President. Gonzalez is indicted in the U.S. in connection with the 1992 killing of U.S. serviceman Zak Hernandez in an act of terrorism done in Panama. After fleeing to a third country for more than two years, Gonzales later returned to Panama and was acquitted by a Panamanian court in a sham trial marred by witness intimidation, harassment of prosecutors, and manipulation of the judge and jury. Gonzales remains wanted by the U.S. on counts of murder, attempted murder, conspiracy to commit murder. In accepting the post on September 1, Gonzalez held out the possibility of stepping down should his presence become an "obstacle" to the U.S. Congress' ratification of the TPA. The National Assembly's decision has been criticized widely by Panamanian commentators, opposition figures, and ordinary citizens.

¶18. (SBU) With opposition parties remaining fractured and so far unable to coalesce into an effective counterweight, the PRD remains well positioned to control Panama's political agenda going into the 2009 elections. As Torrijos is constitutionally prohibited from a consecutive term, various PRD members - including former President Ernesto Perez Balladares, First Vice President/Foreign Minister Samuel Lewis Navarro and his cousin, the Mayor of Panama City Juan Carlos Navarro- have already begun to jockey for position as

the PRD's 2009 candidate. It remains unclear whether or the extent to which the recent Pedro Miguel Gonzalez episode might affect the PRD's 2009 prospects, but the Gonzalez affair indicates that the fissures and divisions within the PRD ranks are more profound than previously thought.

Panama Active on Global and Regional Stage

¶19. (SBU) In late 2006, Panama emerged as Latin America's consensus candidate for a two-year seat on the UN Security Council. This followed a prolonged deadlock between Venezuela and Guatemala. Faced with a steep learning curve at the UNSC, Panama has thus far played a responsible and constructive role and has consistently voted with the U.S. Panama also hosted the Organization of American States (OAS) General Assembly in June 2007, which will focus on "energy for development." President Torrijos has pursued a policy of maintaining friendly

relations with all nations, including hemispheric neighbors such as Cuba and Venezuela.

Good Cooperation on Security & Law Enforcement

¶20. (SBU) As a key link in the global supply chain and a vital transit point for U.S. trade (about two-thirds of the Canal's traffic is bound to or from the U.S.), the Canal presents an attractive and vulnerable terrorist target. Moreover, despite significant progress, Panama continues to be an important transit point for drug smugglers, money launderers, illicit arms merchants, and undocumented immigrants heading north thanks to its proximity to drug-producing neighbors and its status as an important, dollarized, financial center. With USG assistance, Panama has strengthened its ability to detect illegal money and narcotics shipments through Tocumen International Airport. Several GOP agencies participate as part of a Joint Task Force that averages several seizures of narcotics and/or money each week. For example, Embassy law enforcement agencies and the Task Force recently conducted two joint operations that seized at total of \$1.5 million in cash and gold. In March 2007, Panamanian authorities, with critical USG law enforcement support, conducted the largest ever maritime narcotics seizure on the Pacific Coast of Panama. Authorities confiscated a ship containing approximately 20 tons of cocaine with an estimated value of \$500 million. A USG built checkpoint near the Costa Rican border that is manned by various GOP agencies has also made consistent narcotics seizures and interdictions of undocumented aliens.

¶21. (SBU) The GOP recognizes that securing the Canal requires a mature, collaborative bilateral relationship. The Torrijos government is focused on Canal and maritime security and combating terrorism and transnational crime, although it has not yet found the resources to adequately patrol Panama's long Caribbean and Pacific coastlines and to secure Panama's porous border with Colombia against guerrilla infiltration. The GOP is moving ahead with plans to merge its National Maritime Service and its National Air Service into a single "Coast Guard" type of operation. U.S.-Panamanian cooperation in law enforcement and security has steadily improved in recent years. This has led to increasing narcotics seizures, better investigations, active maritime law enforcement, more specialized units, and better detection of money laundering and illicit financial flows. While the USG-GOP relationship is good, Panama's law enforcement institutions are weak and suffer from limited resources and professionalism.

¶22. (SBU) The GOP is acting to end abuses in Panama's open ship registry and mariner identification documents. Panama's ship registry, the world's largest, comprises one-quarter of the world's ocean-going fleet (over 5,000 large commercial vessels). About 13% of the U.S. ocean-going cargo transits the Canal each year. Panama's seafarer registry currently licenses over 300,000 crew members. Port services have grown dramatically in the past decade, as Panama now boasts the leading complex of port facilities in Latin America. In February 2007, the GOP and U.S. Department of Homeland Security executed a "Container Security Initiative" agreement enhance the security of container traffic between our two countries. CSI equipment was began operating in late August at the Balboa Port on the Pacific side of the Panama Canal and will likely be installed by the end of 2007 at the

U.S.-run Manzanillo International Terminal (MIT) in Colon.
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